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Volume 12

Issue 1 *Spring 2002: The Recording Academy  
Entertainment Law Initiative Legal Writing  
Competition 2001-02*

Article 4

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## Can't Record Labels and Recording Artists All Just Get Along?: The Debate Over California Labor Code 2855 and Its Impact on the Music Industry

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### Recommended Citation

Connie Chang, *Can't Record Labels and Recording Artists All Just Get Along?: The Debate Over California Labor Code 2855 and Its Impact on the Music Industry*, 12 DePaul J. Art, Tech. & Intell. Prop. L. 13 (2002)  
Available at: <https://via.library.depaul.edu/jatip/vol12/iss1/4>

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## **CAN'T RECORD LABELS AND RECORDING ARTISTS ALL JUST GET ALONG?: THE DEBATE OVER CALIFORNIA LABOR CODE § 2855 AND ITS IMPACT ON THE MUSIC INDUSTRY**

This article examines the potential impact that the repeal of the 1987 amendment to California's "seven-year statute," which effectively exempts recording artists from the seven-year limitation on personal service contracts, and the possible codification of a seven-year rule into federal law, will have on the music industry.

### **I. INTRODUCTION**

Like the monolithic Goliath who was felled by a mere handful of rocks thrown at just the right spots, the music industry as we know it threatens to be overhauled by the activism of a handful of recording artists who know just where it is vulnerable.

Most notably at the forefront of this emerging battle is Courtney Love, she seeks to terminate her recording contract with record label Vivendi Universal and intends to expose the alleged "unconscionable and unlawful" standard industry contracts and business tactics of the major labels. Her allegations are that the labels purportedly cheat recording artists out of due royalties, claim ownership over original music, and lock them into long-term contracts that are often referred to as "indentured servitudes."<sup>1</sup>

At the heart of Love's lawsuit is her challenge of a 1987 amendment to California's "seven-year statute," California Labor Code § 2855.<sup>2</sup> This statute prohibits the enforcement of personal service contracts beyond seven years from the commencement of service. The amendment subjects recording artists to lawsuits for

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<sup>1</sup> State Senator Kevin Murray, Select Committee on the Entertainment Industry Discusses Personal Service Contracts (2001), at <http://democrats.sen.ca.gov>.

<sup>2</sup> CAL. LAB. CODE § 2855 (2001). The text of § 2855 is reprinted *infra* Appendix A. The 1987 amendment at issue is encompassed in § 2855(b)(2).

damages for failure to deliver albums for which they were contracted during that seven-year term, effectively exempting only recording artists from the seven-year limitation.<sup>3</sup>

The outcry from the artistic community against the 1987 amendment and the practices of record labels led to a hearing by the California State Senate's Select Committee on the Entertainment Industry where several recording artists, labels, and trade groups testified as to whether the amendment should be repealed.<sup>4</sup> State Senator Kevin Murray expects to file a bill to repeal the amendment in January 2002<sup>5</sup> and Rep. John Conyers, Jr., ranking member of the House Judiciary Committee, is set to suggest that Congress create a federal seven-year statute to protect recording artists nationwide.<sup>6</sup>

The amendment has never been challenged in court.<sup>7</sup> If Love should succeed at trial, the economics of the music business may have to be completely restructured.<sup>8</sup> Though the statute is specific to California, the facts, that the music business is heavily based in this state and there is potential for the codification of the seven-year limitation into federal law, suggest that the outcome of this debate will have far-reaching ramifications of an international scope. Free agency might indeed be introduced into the recording industry by Love's well-publicized actions just as free agency was introduced into the movie industry over fifty years ago by actress Olivia de Havilland whose lawsuit against Warner Brothers Studio contributed to the demise of the Hollywood studio system that

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<sup>3</sup> *See id.*

<sup>4</sup> BBC News, *Music Stars Argue Contract Freedom*, available at [http://newsnews.bbc.co.uk/hi/english/entertainment/music/newsid\\_1528000/1528112.stm](http://newsnews.bbc.co.uk/hi/english/entertainment/music/newsid_1528000/1528112.stm) (Sept. 6, 2001).

<sup>5</sup> Chuck Philips, *5 Shows to Build Coffers Against Record Labels*, L.A. TIMES, Dec. 19, 2001, at C1 [hereinafter Philips, *Build Coffers*].

<sup>6</sup> Chuck Philips, *Company Town Lawmakers Take Aim at Music Industry Contracts Recording*, L.A. TIMES, Aug. 8, 2001, at C1 [hereinafter Philips, *Lawmakers Take Aim*].

<sup>7</sup> Philips, *Lawmakers Take Aim*, *supra* note 6.

<sup>8</sup> *See* Chuck Philips, *Dixie Chicks Suing Sony Over Royalties, Accounts Courts*, L.A. TIMES, Aug. 28, 2001, at C1 [hereinafter Philips, *Dixie Chicks*].

used to have a similar hold over its actors and actresses.<sup>9</sup>

First, this article will discuss the conflicts of interest between the major recording labels and recording artists with regards to the 1987 amendment's possible repeal. It will then examine § 2855's history and the court's interpretation of the statute in the context of the movie industry. Lastly, focusing on how the Court's interpretation can be instructive in the present struggle between labels and artists, it will conclude by offering a compromise which will include the repeal of the amendment and a restructuring of the mechanics behind the music business.

## II. RECORD LABELS VS. RECORDING ARTISTS

Approximately 90% of the \$40-billion dollar music business is controlled by five big conglomerates: Universal Music Group, Sony Music Entertainment, Warner Music, BMG, and EMI Group, all which use the same standard industry contracts and policies.<sup>10</sup> The music business is the only one where such giant corporations risk billions of dollars on untested musical acts, only 5% of which ultimately turn a profit.<sup>11</sup> Such high risks exist because of the unique nature of the record music market, which is subjected to constant and unpredictable change in consumer preferences and is characterized by the short life cycle of its products. Also, profitability is based on the impact of individual hit records rather than brand loyalty to individual record labels.<sup>12</sup>

The companies specialize in marketing and promoting records to mass audiences, and they have the capital to take huge financial

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<sup>9</sup> Chuck Philips, *Recording Stars Challenge Music Labels' Business Practices*, L.A. TIMES, Mar. 29, 2001, at A1 [hereinafter Philips, *Recording Stars Challenge*].

<sup>10</sup> Kathleen Sharp, *Recording Artists Sue, Aiming to Rock Industry Action Expected to Put Big Labels Under Scrutiny*, THE BOSTON GLOBE, Oct. 7, 2001, at A6 [hereinafter Sharp, *Recording Artists Sue*].

<sup>11</sup> Philips, *Recording Stars Challenge*, *supra* note 9.

<sup>12</sup> *Panayiotou v. Sony Music Entertainment (U.K.) Ltd.*, (Chancery Division June 21, 1994) (LEXIS \*190 Enggen Library, Cases File).

risks to advance an artist.<sup>13</sup> The fact that “most recording [artists] who have the opportunity to exit the major label system typically resign with [another] major label” indicates the necessity of such a business relationship.<sup>14</sup> Since statistically more than 90% of record releases in a given year fail,<sup>15</sup> and especially now that profit margins are being threatened by digital piracy,<sup>16</sup> “record labels [necessarily] operate on the premise that because they take such [] large financial risk[s] and have such a low rate of success, they should have the right to maximize their return when they [actually] do score a hit.”<sup>17</sup> Furthermore, since failed musical acts in which the labels often invest significant amounts of money are often able to walk away debt-free, the labels must formulate an industry contract which takes into account the risks each party is taking.<sup>18</sup>

Thus, the standard contract is purportedly structured to allow labels to extract much of their earnings from a handful of blockbuster albums.<sup>19</sup> The most controversial contract clause, in light of Love’s challenge of § 2855, is one which gives labels the option to demand four to six and sometimes up to seven albums from one musical act, without which they claim they would not be able to make a profit, even on successful artists.<sup>20</sup> Since no artist is able to turn out seven albums within seven years considering the restrictions put on them by the labels themselves to take two years between record releases to promote the record via tours, music videos, and television appearances, this clause is virtually impossible to fulfill within the bounds of § 2855.<sup>21</sup>

Such quotas allegedly threaten to lock recording artists into

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<sup>13</sup> Chuck Philips, *Record Label Chorus: High Risk, Low Margin Music: With stars questioning their deals, the big companies make their case with numbers*, L.A. TIMES, May 31, 2001, at A1 [hereinafter Philips, *Record Label Chorus*].

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> Chuck Philips, *Courtney Love Seeks to Rock Record Labels’ Contract Policy*, L.A. TIMES, Feb. 28, 2001, at A1 [hereinafter Philips, *Courtney Love*].

<sup>18</sup> Philips, *Record Label Chorus*, *supra* note 13

<sup>19</sup> Philips, *Recording Stars Challenge*, *supra* note 9.

<sup>20</sup> Philips, *Lawmakers Take Aim*, *supra* note 6.

<sup>21</sup> See Sharp, *Recording Artists Sue*, *supra* note 10.

personal service contracts for at least fourteen years, twice as long as the statutorily allotted time period.<sup>22</sup> Even in states that do not have a seven-year rule, keeping artists under contract for such a long period of time is said to hamper the act's ability to discover his or her true market value.<sup>23</sup> Furthermore, contracts usually demand the artist's exclusive services and he or she is thus restricted from recording for any other company until released from the contract or the stipulated number of albums is recorded.<sup>24</sup> On the other hand, without such clauses, industry lobbyists claim that record labels would not have the incentive to underwrite such risky enterprises.<sup>25</sup>

Record labels claim that the economic structure of the industry is fair to artists because they have the option of putting out their own recordings and if they do sign with a label, they do so voluntarily and are paid fair royalties based on "time-honored practices."<sup>26</sup> Moreover, "artists who produce hits [] typically renegotiate for even larger advances"<sup>27</sup> and have the option of exploiting their newfound fame to rake in money from other financial opportunities like commercials, concerts, and acting deals, none of which go to the labels.<sup>28</sup> However, if the 1987 amendment is repealed and/or the seven-year limitation becomes a federal law, the music industry will inevitably have to restructure its standard industry contract in order to do business within the bounds of the law.

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<sup>22</sup> Philips, *Lawmakers Take Aim*, *supra* note 6.

<sup>23</sup> See *Hearings on Recording Artists Exemption to Seven Year Statute: Hearings before the Select Committee on the Entertainment Industry*, California State Senate (Sept. 5, 2001) [hereinafter *Hearings, Testimony of Chaitovitz*] (testimony of AFTRA Director of Sound Recordings Ann Chaitovitz).

<sup>24</sup> See David F. Partlett, *From Victorian Opera to Rock and Rap: Inducement to Breach of Contract in the Music Industry*, 66 TUL. L. REV. 771, 775 (1992).

<sup>25</sup> Philips, *Recording Stars Challenge*, *supra* note 9.

<sup>26</sup> Philips, *Record Label Chorus*, *supra* note 13.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

### III. THE HISTORY BEHIND § 2855

The current litigation between Love and Vivendi is oft compared to the 1944 litigation between actress Olivia de Havilland and Warner Brothers Studios that challenged the interpretation of § 2855 and is said to have contributed to the demise of the movie studio system that used to dictate the careers of Hollywood stars.<sup>29</sup>

The court in *de Havilland v. Warner Bros. Pictures, Inc.* held that the wording of § 2855 should be interpreted as limiting the personal service contract to seven *calendar* years, not seven years of *actual* service.<sup>30</sup> Thus, even though the contract between de Havilland and the defendant producer gave the defendant the right to suspend her for any period of time when she should fail or refuse to perform her services, and provided that the producer had the right to extend the term of the contract for a time equal to the periods of suspension, the statute negated such contractual terms.<sup>31</sup>

The court further reasoned that public policy limited the term to seven calendar years because the ability to change employment after that allotted time, whether to afford a reasonable opportunity to move upward along with increased skillfulness, or exploit new economic conditions, was highly advantageous to the employee.<sup>32</sup> Section 2855 came to be referred as the “de Havilland law” and it allowed actors for the first time to negotiate employment contracts based on their fair market value.<sup>33</sup>

The application of § 2855 in the music industry today has seen different results. In actuality, record labels have avoided testing this law altogether by rewriting the contracts of disgruntled stars and offering large cash advances and higher royalty rates in exchange for more albums.<sup>34</sup> Some labels have allegedly contravened the statute by telling artists that each renegotiation

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<sup>29</sup> Sharp, *Recording Artists Sue*, *supra* note 10.

<sup>30</sup> *De Havilland v. Warner Bros. Pictures, Inc.*, 67 Cal. App. 2d 225, 232 (1944).

<sup>31</sup> *See id.* at 228.

<sup>32</sup> *See id.* at 235.

<sup>33</sup> Laura Dunphy, *Courtney Love's Goliath*, GRAMMY MAG., Apr. 23, 2001.

<sup>34</sup> Philips, *Lawmakers Take Aim*, *supra* note 6.

constituted a new contract with the “seven-year clock ticking anew” or inserting language into the contract suggesting that the deal was subject only to New York even when signed in California.<sup>35</sup>

Around 1985, the Recording Industry Association of America (“RIAA”), the industry’s lobbying arm, launched an attack on § 2855 on behalf of record labels and tried to get the statute extended to ten years.<sup>36</sup> The request was rejected, so the RIAA demanded what later became the 1987 amendment at issue.<sup>37</sup> In lobbying for this amendment, the RIAA argued that the statute as it stood without the amendment was unfair because it allowed recording artists to “walk away from a seven-album recording contract after seven years regardless of whether [they] fulfilled the contractual obligations.”<sup>38</sup> The record industry argued that labels are required to make substantial pre-production investments in the form of monetary advances to bring successful records to the market and that labels often do not recoup those investments nor begin to make profit on even the work of successful artists until they have produced four albums.<sup>39</sup> In addition, lobbyists for the industry also claimed that labels “would be severely injured if the remaining three albums were not delivered.”<sup>40</sup>

Contrary to the arguments of the record industry however, artists working in other fields such as film and literature also often require substantial pre-production investments before he or she achieves a level of success that generates profits for the employing company, but they continue to enjoy the full protection of the seven-year statute.<sup>41</sup> It is argued that record companies need the exemption provided by the 1987 amendment even less than employers in other industries, since unlike artists in other industries, recording artists are almost universally required to pay

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<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> Philips, *Lawmakers Take Aim*, *supra* note 6

<sup>40</sup> *Id.*

<sup>41</sup> *Hearings, Testimony of Chaitovitz, supra* note 23.



the costs to make and promote their own record.<sup>42</sup>

Though no recording artists was ever called to testify at the hearings, the legislature passed the 1987 amendment and subsequently labels were able to sue recording artists for damages resulting from undelivered albums without regard to California's normal limitations period for breach of contract claims.<sup>43</sup>

#### IV. CONSEQUENCES AND COMPROMISE

In regards to whether the 1987 amendment should be repealed or whether the seven-year limitation of § 2855 should become a federal law, a careful balancing of the needs and concerns of both record labels and artists is necessary – taking into consideration the unique nature of the music industry, which might not easily lend itself to comparison with another service industry that works around contractual relationships.

There is concern that repealing the amendment might result in an exodus of record labels from California, thereby impacting the state's economic well being.<sup>44</sup> There is also concern that a repeal of the amendment and the potential codification of § 2855 into federal law will lead to the complete restructuring of the recording industry which has long structured its high-risk, low-margin business around long-term contracts that keep artists bound for years.<sup>45</sup> If the jury decides in favor of Love, labels may be forced to share more power and control with their artists, potentially resulting in heightened competition from smaller labels and, ultimately, the lowering of album prices to the benefit of the consumer.<sup>46</sup> On the other hand, retaining the amendment may diminish the recording artists' incentive to create and unjustly deny them rights that are granted freely to others.<sup>47</sup>

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<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> BBC News, *Music Stars Lead Contracts Challenge*, at <http://news.bbc.co.uk> (Sept. 4, 2001).

<sup>45</sup> See Philips, *Dixie Chicks*, *supra* note 8.

<sup>46</sup> Sharp, *Recording Artists Sue*, *supra* note 10.

<sup>47</sup> See *Hearings, Testimony of Chaitovitz*, *supra* note 23.

According to California Civil Code § 1638, “the language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.”<sup>48</sup> Under § 2855, standard industry contracts which demand options for seven albums, or even four to six, might well be considered to involve an absurdity, since the conditions that record labels put on artists in releasing records make it virtually impossible for an artist to fulfill his or her contractual obligations.<sup>49</sup> Knowing this, it would seem absurd for record labels to make artists sign contracts that they know will inevitably be breached.<sup>50</sup>

Furthermore, the amendment limits personal service contracts to seven years for everyone but recording artists, who arguably need it the most because the value of their work is unascertainable until after it has been exploited.<sup>51</sup> Recording artists often lack negotiating leverage when pitted against sophisticated record labels,<sup>52</sup> and they are required to pay a substantial amount of their royalties to labels that charge them for production, promotion, and packaging of their records.<sup>53</sup> Consequently, the public policy rationale behind § 2855 – to optimize the welfare of employees by allowing them freedom to seek better employment opportunities after a sufficient amount of time – should be applied equally to recording artists without a more compelling justification for exempting only them. The singling out of recording artists is seemingly arbitrary,<sup>54</sup> and though record labels also have legitimate reasons for wanting the amendment’s protection, business-savvy labels are probably in a better position to rebound from the repeal of the amendment than artists could optimally operate under its continued existence.

Labels presumably have the ability to direct their efforts towards

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<sup>48</sup> CAL. CIV. CODE § 1638 (2001).

<sup>49</sup> See Philips, *Courtney Love*, *supra* note 17.

<sup>50</sup> See *Hearings, Testimony of Chaitovitz*, *supra* note 23.

<sup>51</sup> *Hearings, Testimony of Chaitovitz*, *supra* note 23.

<sup>52</sup> Chris White & Dominic Pride, *Michael/Sony Verdict Resolution*, BILLBOARD, July 2, 1994, at 1, 116-117.

<sup>53</sup> Sharp, *Recording Artists Sue*, *supra* note 10 (quoting Don Engle, a longtime music industry lawyer).

<sup>54</sup> See Philips, *Record Label Chorus*, *supra* note 13.

making adjustments that would allow them to maximize their profit margin despite the seven-year limitation. If labels increased the likelihood of investing in successful acts by being more discriminating when signing artists,<sup>55</sup> exercised their ability to charge artists directly for costs of promotional activities (which they often do already),<sup>56</sup> controlled the out-front capital they spend on record projects,<sup>57</sup> and reduced the exorbitant amount of money they spend on promotional giveaways and retail positioning,<sup>58</sup> they might be able to structure contracts to provide them with fewer “options” for albums or draft them in terms of years rather than number of albums.<sup>59</sup> By running the labels more efficiently in general, they might not be compelled to force successful artists to offset the losses of the many failed acts via long-term contracts.<sup>60</sup> By turning a profit on fewer albums from musical acts, they might be able to contract for a number of albums that is actually possible to complete within a seven-year term.

## V. CONCLUSION

The outcome of this debate remains to be seen as Love’s lawsuit is to set to commence at the start of 2002 and government officials have yet to bring the seven-year limitation before Congress. Even taking into consideration the unique nature of the music industry and the pressing business concerns of record labels, the court’s interpretation of § 2855 and the public policy rationale behind the promulgation of such a seven-year rule dictate that the 1987 amendment which excludes recording artists from its protection should be repealed. The resulting restructuring of the music industry should fall more squarely on the shoulders of the major record labels, which are better situated to adjust to the changes.

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<sup>55</sup> *Id.*

<sup>56</sup> *Hearings, Testimony of Chaitovitz, supra* note 23.

<sup>57</sup> *Id.*

<sup>58</sup> Philips, *Record Label Chorus, supra* note 13.

<sup>59</sup> *Hearings, Testimony of Chaitovitz, supra* note 23.

<sup>60</sup> *See* Philips, *Record Label Chorus, supra* note 13.

## APPENDIX A

### Cal. Lab. Code § 2855 (2001)

(a) Except as otherwise provided in subdivision (b), a contract to render personal service, other than a contract of apprenticeship as provided in Chapter 4 (commencing with Section 3070), may not be enforced against the employee beyond seven years from the commencement of service under it. Any contract, otherwise valid, to perform or render service of a special, unique, unusual, extraordinary, or intellectual character, which gives it peculiar value and the loss of which can not be reasonably or adequately compensated in damages in an action at law, may nevertheless be enforced against the person contracting to render the service, for a term not to exceed seven years from the commencement of service under it. If the employee voluntarily continues to serve under it beyond that time, the contract may be referred to as affording a presumptive measure of the compensation.

(b) Notwithstanding subdivision (a):

(1) Any employee who is a party to a contract to render personal service in the production of phonorecords in which sounds are first fixed, as defined in Section 101 of Title 17 of the United States Code, may not invoke the provisions of subdivision (a) without first giving written notice to the employer in accordance with Section 1020 of the Code of Civil Procedure, specifying that the employee from and after a future date certain specified in the notice will no longer render service under the contract by reason of subdivision (a).

(2) Any party to such a contract shall have the right to recover damages for a breach of the contract occurring during its term in an action commenced during or after its term, but within the applicable period prescribed by law.

(3) In the event a party to such a contract is, or could contractually be, required to render personal service in the production of a specified quantity of the phonorecords and fails to render all of the required service prior to the date specified in the notice provided in paragraph (1), the party damaged by the failure shall have the right to recover damages for each phonorecord as to which that party has failed to render service in an action which, notwithstanding paragraph (2), shall be commenced within 45 days after the date specified in the notice.

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